

## CHINA'S ENERGY INSECURITY AND THE SOUTH CHINA SEA DISPUTE

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## **ABSTRACT**

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China's unprecedented economic growth and modernization have accelerated China's demand for energy resources, especially oil. Recently, China emerged as the second largest consumer of oil behind the United States (US) and now imports over 50 percent of its oil requirement. In fact, analysts estimate China's demand for oil will exceed global production capacity by 2030, possibly sooner. As the global demand for energy rises, China's geo-strategy includes securing access to oil while possibly leveraging the ability to deny access to others. China's "Go Out" economic policy and its mercantilist approach to controlling energy resources combined with aggressive trade agreements that include weapons, advanced technology, and/or loan deals for oil reflect China's growing energy security dilemma. The South China Sea's 7.5 billion barrels of proven oil reserves as well as extraordinary estimates of oil/natural gas reserves in the heavily disputed Spratly and Paracel Island regions stand to raise the stakes of interested parties including the US. Given China's rise and its territorial claims to not only the islands, but the vast majority of the South China Sea and its resources, it remains unclear whether such claims will become a platform for cooperation or conflict.





## CHINA'S ENERGY INSECURITY AND THE SOUTH CHINA SEA DISPUTE

Globalization has changed how states pursue vital interests to include securing natural resources. Ever since oil became a resource of strategic and political power at the onset of World War I, energy has contributed significantly to the security and welfare of the state.<sup>1</sup> As China and its South East Asian neighbors' economies and populations continue to grow and modernize, the appetite for quality of life improvements will undoubtedly lead to competition for scarce resources including food, water, and certainly energy. With global demand expected to soar 45 percent by 2035, and the uncertain future of alternative energy sources, oil remains central to the civilized world, and with that, a potential source of conflict.<sup>2</sup>

Under President Hu Jintao's leadership, the People's Republic of China (PRC) has skillfully downplayed its previously touted "Peaceful Rise" to that of "Peaceful Development/Co-existence." However, China's economic growth and modernization have accelerated its demand for energy resources, forced China to seek access to resources abroad, and garnered international concerns regarding China's energy security. As part of its 2002 "Go Out" economic policy, China is making aggressive investments abroad in pursuit of energy resources and brokering deals often in exchange for Chinese weapons, advanced technology, and/or loans.<sup>3</sup> Over the past 8 years, this policy and China's mercantilist strategy have helped China project its soft power in such energy-producing states as Sudan, Angola, Venezuela, Iran, Russia, Kazakhstan, Myanmar, and others to leverage China's access to oil and natural gas.<sup>4</sup>

Like other countries, China perceives economic growth and unhindered access to energy as key components to its national security; however, as energy expert Daniel

Yergin asserts, “Oil shares an intimate relationship with national strategy, global politics, and power.”<sup>5</sup> As demonstrated by Japan in the 1930s, economic growth, power, and energy dependence have a tendency to create intrastate and interstate instability, eventually altering the balance of power between states and regions.<sup>6</sup> Similarly, China’s growth has raised tensions with the US, especially regarding Chinese investments and acquisitions in the energy sector as well as its claims to territories in the heavily contested South China Sea. China’s extensive territorial claims accompanied by overlapping Exclusive Economic Zones (EEZs) in the South China Sea serve to potentially alter accessibility to natural resources and jeopardize freedom of navigation rights for not only China’s neighbors, but the international community.

Furthermore, China has brokered energy deals with states that undermine US interests particularly when it comes to human rights and the proliferation of dual-use nuclear technology that could lead to the production of weapons of mass destruction (WMD). The US, members of the European Union (EU), the Association of Southeast Asian Nations (ASEAN), and others have all scrutinized China’s intentions especially in light of its military build-up which includes expanding its blue-water navy to presumably control the South China Sea and its resources. China’s increasing demand for oil, the territorial dispute in the South China Sea, its affirmation of energy as a “core interest” and the measures it is taking to mitigate its energy insecurity serve to potentially destabilize the Pacific region.

This paper examines China’s energy insecurity and its implications over the South China Sea dispute – namely the Spratly and Paracel Islands. First, it will assess China’s energy insecurity and its relationship to China’s “Go Out” economic policy.

Next, it will analyze the potential impact of energy on the Spratly and Paracel Islands dispute. Finally, it will explore the contributions of international organizations charged with promoting energy security to build a better understanding of China's energy security dilemma and its implications on a US strategy for coping with the South China Sea dispute.

### Background

The Peloponnesian Wars demonstrated that conflict and war, as human endeavors, can be largely attributed to perceptions of "fear, honor, and competing interests."<sup>7</sup> Given this, analysts have written extensively on the rise and fall of empires to analyze the relationship between interests and power. However, energy adds a remarkably different dimension to the power equation that, until recently, remained mostly unchallenged with relatively few major competitors. With China's rising demand for energy, it stands to potentially inject uncertainty and competition that could upset the international system's balance of power. Until recently, the international system and its energy sector have remained stable primarily as a result of resource availability, interdependence, and the shared responsibilities that accompany open markets and global trade. However, as history suggests, interdependence requires an acceptance of risk that some states may deem unacceptable especially as resource availability declines and when there is mistrust or a perceived inability to act upon self interests.

For the last 30 years, despite US power projection, energy resource competition, and the issue of Taiwan, the US, China, and its neighbors have avoided confrontation largely because of economic interdependence. Ultimately, such interdependence has helped China supply the world with cheap manufactured goods and sustain a 9 percent

annual growth rate, while also having absorbed \$900 billion of a US debt currently over \$14 trillion.<sup>8</sup> However, with its new found prosperity and population surge expected to reach 1.4 billion by 2020, China's rise is straining its ability to satiate energy demand and increasingly raising tensions that accompany resource competition. According to author and realist John Mearsheimer's theory on international politics, competition leads states to attempt to establish hegemony and dominate their own region while making sure no rival great power dominates another region.<sup>9</sup> This realist perspective suggests growth and modernization stand to serve China's larger aim which is to capitalize on as much power as possible to maximize the power gap between itself and its neighbors.

Throughout history, China had espoused a strategy of self reliance to meet its energy requirements and preserve national security because it possessed adequate resources to do so. With an abundance of coal and oil, China has been able to satisfy energy demand, yet China's dependence on coal, which services 69 percent of its energy needs, is creating excessive pollution ultimately threatening agriculture and raising health concerns.<sup>10</sup> Likewise, China has the third largest proven oil reserves in the world accounting for over 21 percent of its energy needs; however, most fields have reached peak production and are beginning to decline. Although natural gas and hydro-electric power are gaining momentum, coal and oil remain China's predominant energy sources and continue to service the industrial and transportation sectors forcing China to seek measures to mitigate demand as well as its environmental issues.

In 2010, China consumed over 8.1 million barrels of oil per day (bpd) while Japan, its nearest regional competitor consumed 4.4 million bpd (See Figure 1).<sup>11</sup> As shown, both countries are also major importers of oil with disproportionate production-

to-consumption ratios. More recently, China overtook Japan as the world's second largest energy consumer accounting for nearly 17 percent of global supply with 50 percent of its oil requirement derived from imports, second only to the US.<sup>12</sup> This can be attributed to China's growing middle class and the demand for automobiles as well as modern appliances. Assuming analysts' estimates are correct, a 3 percent annual rise

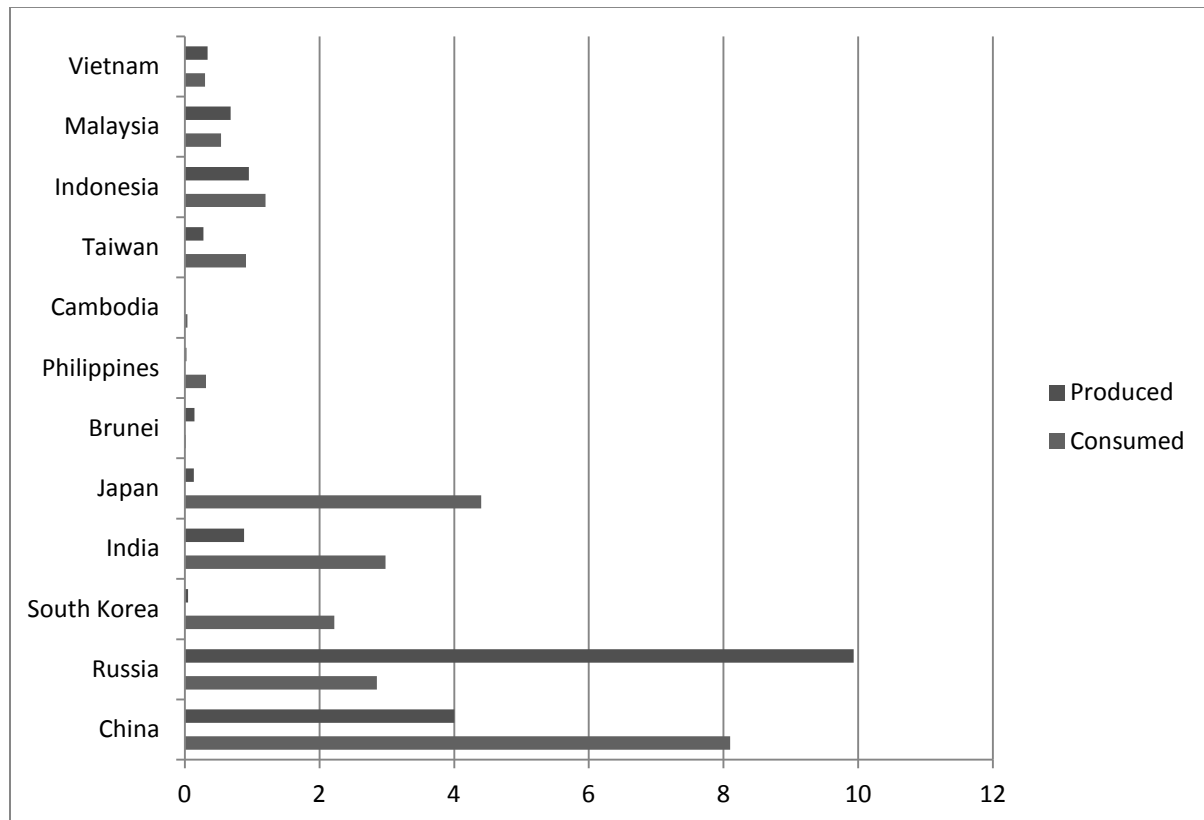


Figure 1. 2010 Oil Production versus Consumption (in millions of barrels per day).<sup>13</sup>

in demand will drive China's oil requirement to over 11 million bpd by 2020 with 70 percent of it derived from imports.<sup>14</sup> Without additional discoveries or alternative fuel sources, experts predict global oil supply will struggle to meet China's demand potentially jeopardizing its upward trajectory which could have a tremendous impact on the global economy. Fortunately for China and its neighbors, the South China Sea

affords great potential for offsetting this forthcoming energy dilemma. The South China Sea's 7.5 billion barrels of proven oil reserves (20 billion barrels of unproven reserves) as well as oil/gas reserves in the heavily contested Spratly and Parcel Island regions (2.1 billion barrels oil and 266 trillion cubic feet of natural gas) offer great potential for servicing regional energy demands.<sup>15</sup> However, energy resources also serve to potentially raise tensions if China chooses to exploit them at the expense of its neighbors and the international community.

In 2010, China reasserted ownership to nearly 80 percent of the South China Sea, supplementing its claims to the Spratly and Paracel Islands. For China and its neighbors, territorial ownership is integral to state sovereignty and security. However, overlapping EEZs, disputes over ownership of the Spratly and Paracel Islands, and China's mercantilist approach to securing resources stand to raise the energy security stakes of interested parties including the US.<sup>16</sup> Feelings of insecurity of those with competing interests in either the EEZ or the Spratly or Paracel Islands could prove challenging especially if China expands its offshore production of oil/natural gas and extends its control over the vessels or pipelines that deliver them via the South China Sea.

Experts suggest energy shortages provide the necessary catalyst for arms races, nuclear proliferation, and other forms of instability... in essence, greater energy insecurity equates to the greater probability of geopolitical rivalry.<sup>17</sup> Like the US, as China becomes more dependent on oil imports, its ability to ensure access to energy at an affordable price becomes even more critical and could prove difficult given increasing global market uncertainty. Ultimately, China's dependence on imports could

lead to a vicious cycle as it struggles to find ways to mitigate risks and protect its investments in order to offset its insecurity.<sup>18</sup> Given global dependence on China's economy and the potential impact of shrinking energy supplies, this warrants special consideration in the geo-political realm.

### China's Energy Security Dilemma

Energy security is largely a measure of a state's vulnerability to disruption of energy resources and is a function of supply diversification, domestic production, efficiency, and geo-political management including transportation.<sup>19</sup> For purposes here, the overarching considerations in China's energy insecurity and its relevance to the South China Sea dispute are its strategy for diversifying oil supply and securing transportation routes. China's failure to diversify supply in anticipation of its rising demand stands to potentially derail its modernization effort and is contributing to China's energy insecurity. Over the last several decades, China has had a history of energy crises that stem from its poorly designed infrastructure, inefficiency, miscalculations, and misguided energy policy.<sup>20</sup> In fact, until the early 1990s, China relied predominantly on its domestic oil and coal reserves to service its energy needs with a relatively flat demand for oil. Predicated by Mao Zedong's concept of slow and sustained growth and development that stressed "self-reliance," China dedicated most of its effort to on shore energy projects void of outside technical assistance.<sup>21</sup> As a result, China's supply diversification and ability to efficiently extract resources have been hampered by insufficient technology that has been largely underdeveloped since losing Soviet technical assistance in the late 1960s.<sup>22</sup> Given this and China's overarching policy that opposed foreign intervention, China devoted little effort toward diversifying its domestic

energy supply or improving efficiency to bolster its energy security.

Eventually, China awoke to the reality of having insulated itself from an industry dominated by foreign competition that already controlled most of the existing oil exploration blocks. In addition, foreign companies successfully held major stakes in deepwater exploration and production projects that left China with little room to maneuver. Without the technological means to exploit resources in the East and South China Seas, China turned to Japan, France, and the US for joint ventures in the East and South China Seas; however, most proved either uneconomical or of limited return due to immature deepwater extraction technologies.<sup>23</sup> Given limited exploration and lagging efforts to improve infrastructure, China fell victim to an inadequate energy plan to accommodate its rising oil demand – an expected byproduct of economic growth.

Over the past several years, China has made considerable investments in its infrastructure hoping to improve its position. In fact, China has successfully negotiated pipeline projects with Russia, Myanmar, Taiwan, and Kazakhstan as well as instituted plans to boost its strategic petroleum reserve (SPR) capacity to 90 days.<sup>24</sup> In addition, exploration has yielded new discoveries of natural gas which could offset China's domestic energy supply diversification problem. However, China's vast territorial and technological limitations will hinder its efforts unless China encourages greater foreign investment and, in turn, acts responsibly to build mutual trust and confidence with international business partners. Unfortunately, China's history of industrial spying and, most recently, allegations over computer hacker intrusions targeted at the US government and its companies subvert any immediate hope for improving foreign business relations between companies seeking to trust the Chinese.<sup>25</sup>



With little trust between China, its neighbors, and the US, inadequate energy supply diversification is pushing China toward closer relations with states intrinsically linked to international terrorism, organized crime, weapons proliferation, and human trafficking. Globally, China is striving for energy security in ways that lead to even greater resource competition and potentially undermine US efforts toward global security. Ultimately, although the US has a keen interest in deterring relations with states that contradict its values and interests, China's perception and approach to international relations is quite different.

Perhaps China's actions at home and abroad, as well as the predictability of future actions in the South China Sea are best understood through China's ideology and perception of power. China's holistic view of the world stresses the interrelationships between the strength of its political system, economic development, military, territory, population, and control of natural resources as measures of overall power.<sup>26</sup> Furthermore, such interrelationships are devoid of the use of force or other measures to control or interfere in the internal affairs of others – what China deems hegemony.<sup>27</sup> Like Japan in the 1930s, China shares the same sense of external pressure, from what it perceives as US hegemony, on its internal affairs and its ability to access natural resources. Ultimately, China's 5,000 year lineage overshadowed by war, occupation, and fear of isolation have created a “unifying consciousness” stressing unity, sovereignty, and power through territorial integrity and economic growth which dictate its interactions with the rest of the world.<sup>28</sup>

In contrast to the US which shares 2 borders, China's territorial integrity is checked by 14 bordering countries which subject it to tensions resulting from

globalization and economic and political influences beyond the appreciation of US counterparts. Over time, globalization coupled with China's growing dependence on foreign resources and the international market, have allowed capitalism to permeate China's borders serving to potentially undermine the control of the Chinese Communist Party (CCP), the collective nature of its society and hence, its power and security.<sup>29</sup> As a result, China doesn't trust its neighbors or the US due to subjugation to an international system largely dominated by the US. With little trust in the international community and its ability to ensure unhindered access to energy resources, China is simply seeking to reduce uncertainty by gaining power to ensure its survival.

### The Power of Energy

China has risen as a major player in the international system; however, its economic growth is only sustainable if it is able to secure the resources necessary to fuel it. As a result, China's latest National Energy Security Plan is aligned to diversify suppliers, invest in foreign production, develop pipeline infrastructure, and create a strategic oil reserve as leverage against any future impediments to energy resource procurement.<sup>30</sup> As China's economic power grows, it has little choice but to seek resources abroad in an effort to break what it perceives as a barrier overshadowed by remnants of US foreign policy dating back to the Cold War.<sup>31</sup> Comprehensively, this means investing in and owning energy resources abroad which, undoubtedly, harnesses tremendous power – the power to influence and potentially control the world.

Strategists argue that because of the interaction between energy, politics, and power, the US must exercise every possible opportunity to exert its influence on China and therefore, make the US indispensable to China's rise.<sup>32</sup> America's past "Cold War"

affiliation, its containment policy toward China, Korea, Vietnam, and the former Soviet Union as well as on-going operations in Central Asia, have contributed greatly to China's perception of the world and the power it must hold to compete in it. Former US National Security Advisor and foreign policy expert Zbigniew Brzezinski asserts that China's survival depends on its ability to hold as much power as possible relative to other rivals and predicts that China is likely to try to dominate Asia.<sup>33</sup> As part of this power game and to preserve its energy security, China has exercised its UN veto authority over economic sanctions with Iran and Sudan while also preparing itself militarily to respond to disrupted energy supply lines.<sup>34</sup> Given US interests in the Pacific, bridging any emerging regional power gap would seem integral to mitigate the possibility of China manipulating the global energy market or negatively influencing regional stability. Historically, this has motivated the US to seek to contain what clearly constitutes an emerging threat; however, it may have underestimated China's resilience toward external influence.

Containment holds significant meaning to not only the Chinese, but certainly members of the CCP who have had to contend with the gradual liberalization of Chinese society to sustain its position of power. Despite much rhetoric over the declining influence of the CCP, greater than 90 percent of the richest businessmen in China belong to the CCP, which advocates a mercantilist or limited-market economy.<sup>35</sup> China's mercantilist approach to energy equates to owning it at the source which serves to extend the CCP's influence into the energy sector. The CCP also upholds China's widely criticized foreign policy regarding non-interference in the internal affairs of the state which China applies to its investments abroad. Most importantly here, the CCP

retains significant influence on China's three state-owned national oil companies (NOCs) that not only control its oil market, but compete internationally in the energy sector – PetroChina, the China Petrochemical Corporation (SINOPEC), and the China National Offshore Corporation (CNOOC).<sup>36</sup>

Although the CCP's relationship with China's NOCs has proven beneficial politically, it remains weak in the global energy market. In fact, even with its recent investments, China has relatively little influence on the energy sector and only controls about 1 percent of the overall market – a key vulnerability. In comparison, the Middle Eastern oil companies which are also largely NOCs have dominated nearly 80 percent of global supply for the past 27 years through the Organization for Petroleum Exporting Countries (OPEC). Historically, the International Oil Companies (IOCs) held a majority stake in the global market; however, with the trend toward nationalization, the 6 remaining IOCs now control only approximately 7 percent of the world's oil.<sup>37</sup> Nevertheless, the fact that 3 of the 6 International Oil Companies (IOCs) that operate globally today are still largely American owned serves as a persistent reminder of US power and influence in the energy sector.

Over the past decade, China has expressed displeasure with US hegemony and a desire for a multi-polar world as part of its “new security concept.”<sup>38</sup> As China's energy insecurity has unfolded, its vulnerabilities have exposed China to the realities of the oil industry. Historically, the oil industry has been plagued by a corrupt past attributed to the rise of an American enterprise that largely controlled the world's energy sector. As demonstrated by World War II, the Yom Kippur War, and the Gulf War, wars have been fought over and won with oil – oil that has always been subject to disruption

either through destruction or merely the control of production platforms or transportation nodes. As early as 1892, oil demonstrated its strategic significance through its susceptibility to disruption when kerosene tankers were blocked in the Suez Canal and later, as a prelude to Japan's attack on Pearl Harbor as well as US intervention in the Middle East.<sup>39</sup> More recently, Russia's use of energy to leverage its political power by cutting off oil to China and natural gas to Europe have only exacerbated China's dilemma.<sup>40</sup>

Given US dominance and a foreign policy that has largely emphasized containment, it's logical to assume China perceives the US as a threat to its energy lifeline and survival. In 2005, China made an unsuccessful bid for American-owned oil company Unocal following what China deemed a politically-motivated block by US Congress. Unfortunately, the action also served to bolster China's claims over US protectionism, containment, and potential ambitions to control the energy sector by diverting resources away from the international market.<sup>41</sup> Ultimately, China's perception of US actions has bolstered resentment among the Chinese who feel as if they have been left out and have little choice but to project their new found economic power abroad to remain competitive with the US.

At the moment, China's leadership remains focused on regime survival, territorial integrity, and domestic stability.<sup>42</sup> Fundamentally, whether or not the CCP retains its power, depends on its ability to secure energy. As Wang Haiyun, a member of China's State Council asserts, "Energy represents a strategic weapon of significant interest to the state in pursuit of its political, economic, and security interests."<sup>43</sup> Given China's energy outlook, the CCPs influence, and the potential weaponization of energy, it offers

greater perspective into China's military modernization initiatives. These include using the Peoples Liberation Army (PLA) as well as the Peoples Liberation Army Navy (PLAN) for not only defense, but to construct and secure energy facilities as well as protect its sea lines of communication (SLOCs).<sup>44</sup>

Fundamentally, China like the US is skeptical of the reliability of other nations to service its energy needs given the volatility and uncertainty of suppliers. As a result, President Hu Jintao made energy access integral to China's survival and a key component of its foreign policy.<sup>45</sup> As part of its economic reform program, China is making concerted efforts to ensure economic growth isn't curtailed by a lack of energy resources or interruptions to supplies.<sup>46</sup> Although the US has taken energy security seriously since the oil embargo of 1973-74, China has only recently begun to appreciate its vulnerability which explains the strategic actions it is taking abroad to mitigate its risks. However, China's oil and natural gas investments abroad create regional stability issues especially when the supplier is state-owned and/or has a controlling interest.

State-owned enterprises are credited with the ability to assure oil supplies while mitigating price volatility in support of economic development. Although still a minority stakeholder in its oil ventures, on average, CNOOC owns between 30 and 40 percent of the oil companies it has invested in. In Sudan, China holds a 40 percent stake in its venture with Greater Nile Petroleum Operating Company which, in recent years, has exported nearly 60 percent of its oil to China and struck weapons deals for small arms, tanks, fighters, mortars, and rocket-propelled grenades worth hundreds of millions of dollars.<sup>47</sup> In some cases, China's NOCs have sought to gain ownership of a significant number of oil exploration and production blocks abroad with the promise of boosting the

economies of host nations. However, studies show China has predominantly used Chinese workers, often transferred weapons as payment, and flooded markets with cheap Chinese imports that devalue locally-produced goods and contribute to localized unemployment while leaving China as the prime beneficiary.<sup>48</sup> For example, although China has invested over \$40 billion in Venezuelan oil, its investments have largely been in exchange for Chinese radar systems, fighters, and even rumors of the acquisition of US F-16s.<sup>49</sup>

China is aware of the history of conflicts and wars that have emerged as a result of state efforts to control resources, yet, it also realizes that without seeking its share of the energy market and developing the military capabilities necessary to assure access to energy, its fate is left to chance. Therefore, China's pursuit of a blue-water navy combined with its economic expansion abroad should be expected when faced with the threat of strangulation resulting from a severed energy lifeline. Most importantly, it raises the significance of the South China Sea dispute because of the potential influence of Chinese mercantilism on energy resource acquisition, the US, and its regional partners.

Although China has yet to manipulate energy supplies, it demonstrated its willingness to control resources when it cut rare earth element exports by 40 percent in the summer of 2010 resulting in soaring prices and greater tensions with Japan.<sup>50</sup> Whether China's actions were simply by-products of diplomatic immaturity or a deliberate effort to exercise power, China must appreciate the message its actions represent and the perceptions garnered by the international community.

## Oil and the South China Sea

The South China Sea presents a potential opportunity for China to use its territorial claims to gain control of oil/natural gas reserves to deny access to or disrupt supplies. As shown in Figure 2, the region contains the heavily disputed Paracel and Spratly Islands with overlapping claims to various areas and energy exploration blocks by China, Taiwan, the Philippines, Vietnam, Indonesia, Malaysia, Brunei, and

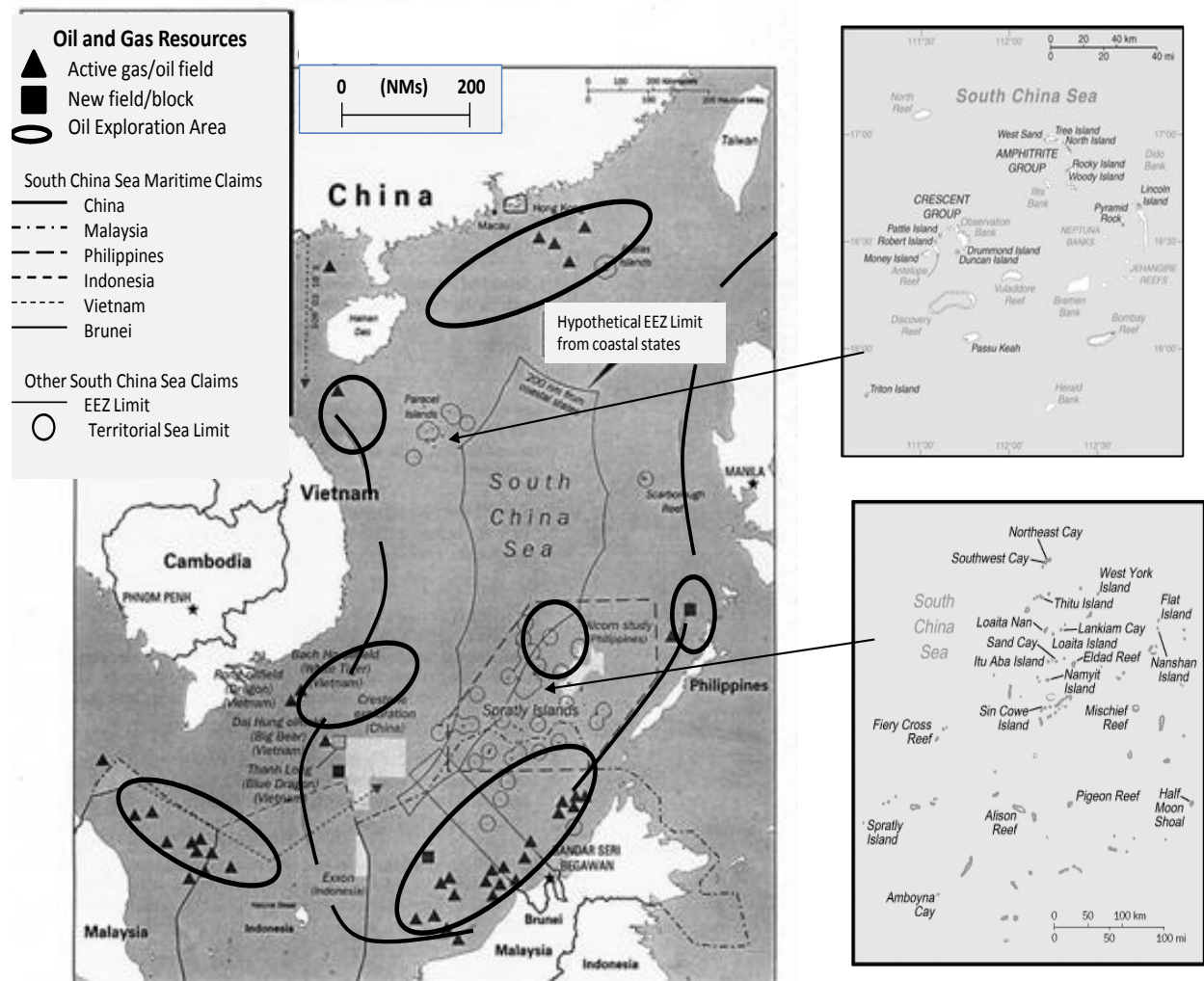


Figure 2. The South China Sea, its Contested Areas Including the Spratly and Paracel Islands, and Territorial Claims of Competing Parties.<sup>51</sup>



Thailand.<sup>52</sup> Over the last 20 years, there have been at least 10 documented disputes over energy exploration rights and 17 military confrontations in the South China Sea and its territories.<sup>53</sup> Some confrontations have resulted in deaths while most have merely jeopardized attempts to exploit energy resources, most significantly between China, Vietnam, and the Philippines. Ultimately, China's extensive claims raise US suspicions over its intent to potentially control the South China Sea and its resources. Such suspicions have evoked strong criticism from the US which espouses "to intercede to ensure safe passage through international waters" as prescribed by the 1982 United Nations Convention for the Law of the Sea (UNCLOS).<sup>54</sup>

Under the UNCLOS, states have sovereign rights to explore, exploit, conserve, and manage the natural resources within an EEZ which can range to 200 nautical miles (nms) beyond a state's territorial sea.<sup>55</sup> China's loose interpretation of the UNCLOS has permitted it to claim territory and establish an EEZ that stretches to nearly 1,000 nms beyond mainland China and encroaches upon the sovereignty of its neighbors. Notably, most of the Spratly Islands are submerged at high tide and don't meet the legal criteria necessary for EEZs.<sup>56</sup> Furthermore, although a signatory to the UNCLOS, China unilaterally established its own measure through its 1992 Law on Territorial Waters and their Contiguous Areas. This solidified the Chinese claim to the Spratly and Parcel islands as well as empowered the People's Liberation Army (PLA) to employ force to defend the islands.<sup>57</sup> Citing this, UNCLOS, and historical records, China claims ownership of roughly 80 percent of the South China Sea including areas that encompass existing oil fields operated by Brunei and Indonesia. China bases such claims on historical references to exploration, naming, utilization, government

jurisdiction, and acceptance of the Japanese surrender following World War II to validate its sovereign control of the area, yet this isn't codified anywhere in international law.<sup>58</sup>

Much has been written regarding the various claims to the Spratly and Parcel Islands and the surrounding waters to include China's attempts to inhabit the islands.<sup>59</sup> To summarize, each of the 6 claimants base claims to various islands under such circumstances as sovereignty, discovery and rights to the EEZ. Although the claimants appear willing to agree to joint development, all have been unable to agree on exactly how to pursue it without fear of relinquishing sovereignty.<sup>60</sup> China faces a similar dilemma with Japan over exploration and production in the East China Sea following differences in the interpretation of exactly what joint development means.<sup>61</sup> Excluding Taiwan, all claimants are signatories to the 2002 Declaration of the Conduct (DoC) of Parties in the South China Sea which calls for peaceful resolution of disputes; however, reaching consensus over the definition of sovereignty remains critical to resolving the dispute.

Historically, states exercised sovereign control over territories based on the fact they used them for trade, exploration, or means to subsist. As eluded to earlier, and a key issue in this dispute, China views sovereignty as a reflection of a state's scope of control or influence on people which, as mobile entities, negates any real possibility of prescribing sovereignty by linear boundaries.<sup>62</sup> In essence, China's view of sovereignty is governed by its influence on territory, not by habitation although it has certainly taken measures to inhabit its claimed territories. In contrast, under UNCLOS, sovereignty is interpreted as a state's ability to exercise "uninterrupted administrative control over the

area in question” meaning that the territory must be inhabitable or able to sustain economic life.”<sup>63</sup> China argues that this definition cannot be used as a replacement for historical record and, therefore, has been reluctant to adhere to guidance established under UNCLOS despite having ratified the law. Nevertheless, China’s effort to establish administrative offices on Hainan Island suggests China is seeking additional legitimacy to claims for islands it already inhabits.

To date, UNCLOS and its Commission on the Limits of the Continental Shelf (CLCS) remain heavily scrutinized due to inability to fully address the territorial issues at hand and the question of state sovereignty. From the author’s perspective, it’s also indicative of an international law mismatched with emerging technology that includes both deepwater and horizontal drilling apparatus much more capable of exploiting resources in the South China Sea than those just ten years ago. Although a signatory to UNCLOS, China has firmly held its ground having decided instead to denounce claims of competing parties, avoid multilateral negotiations, and deter external influence especially by the US.<sup>64</sup> If China or any of the claimants choose to abuse their rights under UNCLOS which might include harassing, boarding, and searching foreign-flagged vessels in their EEZs, it could exacerbate the problem further.<sup>65</sup>

China’s approach to achieving resolution had largely been passive until it moved forward with a proposal for joint development in 2004. Under the 2004 Joint Development Agreement (JDA), China, Vietnam and the Philippines agreed to jointly develop the areas adjacent to the Spratly and Paracel Islands by putting aside the sovereignty issue. However, the agreement went awry in 2008 following Filipino suspicions over Chinese ambitions to control the area and tensions over the “tri-partite”

agreement that left out other claimants with interest in the EEZ. As a result, China has poised itself to potentially withdraw from DoC fearful of the limits it imposes on bilateral negotiations.<sup>66</sup> Although China has successfully settled 17 of its 23 territorial disputes, joined multi-national groups like the Shanghai Cooperation Organization (SCO), Association of Southeast Asian Nations (ASEAN), and Asian Pacific Economic Cooperation (APEC); it still espouses to settle the South China Sea dispute bilaterally void of external influence.<sup>67</sup>

China had also largely avoided multinational oil ventures; however, CNOOC has recently negotiated oil exploration and production contracts with the CACT Operators Group (China/Italy/US), Husky Energy (Canada), Devon Energy (US), and Kerr-McGee (US). Notably, Chinese law ensures CNOOC retains the right to a 51 percent stake in any commercial discovery as well as rights to assume operations once foreign companies' development costs are recovered.<sup>68</sup> Nevertheless, China's growing multinational affiliation in the energy sector should serve as the foundation for formulating the cooperative strategy necessary to mitigate this dispute.

### Multilateral Efforts

China faces an additional challenge that accompanies economic growth - the call for expanded multinational engagement. Therefore, a significant piece of China's peaceful rise entails it assuming a major role in the international system that includes bettering the interests of its neighbors. Like others, China must accelerate its energy diversification plans and capitalize on foreign oil company investments to explore and harvest the energy resources in the South China Sea without concern for holding a major stake in such projects. This will entail a detailed and legally binding joint

development agreement (JDA) that services the requirements of all the claimants to the Spratly and Paracel Islands as well as those with overlapping EEZs. However, China's powerful stance over sovereignty will require it to take a subordinate role and instead, grant legal jurisdiction over the JDA to an international forum. Given the ensuing competition over energy resources, it is imperative parties seek resolution through a multilateral forum such as ASEAN, the ASEAN Regional Forum (ARF), or the International Energy Association (IEA) sooner rather than later. Such a forum will help claimants strengthen credibility to build confidence in interdependence, raise awareness of what actions communicate to observers, and align words with actions.

China's newly formed National Energy Commission (NEC) combined with the National Development and Reform Commission (NDRC) are key to formulating China's national energy development plans, addressing energy security, and promoting international cooperation.<sup>69</sup> However, the real weight offered by a multinational energy security platform such as the International Energy Agency (IEA) is absent since neither China or any of the claimants to the dispute are members. Furthermore, none of the claimants are members of the requisite Organization for Economic Cooperation and Development (OECD) and only China holds observer status.<sup>70</sup>

Although unfortunate, it does speak to the credibility that OECD seeks with the international community given its qualifying criteria including a gross domestic product (GDP) of at least \$3,000, strategic petroleum reserve (SPR) requirements, and standards for human rights.<sup>71</sup> At the same time, one could argue China's non-member status only dilutes its ability to weigh in on pertinent economic and energy discussions leaving it, once again, isolated from a global issue. Certainly, a better approach might

include some sort of OECD member guarantee that would afford non-member countries SPR protection in the event of an emergency. Such a move could also help discourage Chinese mercantilism by reinforcing security cooperation through mutual affiliation. China can help bolster its position by continuing to participate in IEA workshops and engaging the NEC to disclose energy data and statistics necessary for improving energy demand forecasts so that the market can anticipate requirements.

Similarly, China's relationship with ASEAN and APEC is encouraging following the recent ASEAN-China Free Trade Agreement (ACFTA) which has liberalized trade by promoting greater interdependence.<sup>72</sup> China is a member of APEC and key contributor to ASEAN through its ASEAN Regional Forum (ARF) which should serve as the platform for coordinated discussion to address regional political, economic, and social concerns. More importantly, ASEAN could serve as the forum to broker joint development agreements to ensure equitable shares of South China Sea resources. Unfortunately, one cannot discount the clashes China had with ASEAN in the 1990s including ASEAN requests for demilitarization of the disputed territories which China outright rejected.<sup>73</sup> China's insincere response served to humiliate ASEAN members and has led members to question China's resolve to cooperate on regional security matters.

As this matter has evolved, it is now undoubtedly a security issue of strategic interest to the international community. Therefore, the United Nations (UN) probably bears overall responsibility for forging a strategy conducive to peaceful resolution. Given the UN's jurisdiction over UNCLOS, it only seems reasonable to expect claimants to subscribe to international law which cannot be left to interpretation. However, one

can surmise the reason this dispute has remained beyond the focus of the UN is because China fears losing sovereignty to UN intervention. International law permits the claimants to pursue resolution bilaterally or multilaterally, yet, pending non-resolution, the International Court of Justice (ICJ) will ultimately bear responsibility for rendering a verdict.<sup>74</sup>

An ICJ verdict could end up solving the territorial dispute, but exacerbating regional competition to include claimants withdrawing from the ACFTA or, at worst case, severing diplomatic relations. In 2002, the ICJ rendered a verdict over a territorial dispute involving the islands of Pulau Ligitan and Pulau Sipadan claimed by Malaysia, Indonesia, Borneo, and the Philippines. Ultimately, the ICJ ruled in favor of Malaysia without regard for the natural resource boundaries that were also in question.<sup>75</sup> As a result, claimants have carried this dissatisfaction forward which affords further justification as to why the South China Sea dispute remains unresolved. Nevertheless, the US must remain engaged with the UN on this issue and encourage members to take a firm position over the territorial dispute.

#### Implications on US Strategy

China's affirmation of energy as a core interest and renewed attempts to extend its sovereignty throughout the South China Sea should serve as warnings throughout the international community. International criticism over human rights, child labor and international trade violations may appear effective, but it can only be effective if the means are available to modify behavior. Fundamentally, China's ideology, mistrust, and genuine disinterest in the internal affairs of state business partners are diametrically opposed to not only US interests, but global interests. In order for China's economic

policy to matter, it must consider both near-term and long-term implications of its investment practices abroad. Although internal security is fundamental to China's sovereignty, it serves relatively little purpose if unable to accommodate basic human needs integral to survival.

Since 2007, the US has made tremendous efforts to reengage with Southeast Asia to reassert its leadership on economic, political, and security affairs. However, the US has probably remained reluctant to fully engage on this issue because it never ratified the UNCLOS as having described it as contradictory to the concepts of free-market capitalism. In July 2010, US Secretary of State Hilary Clinton reassured ASEAN of US intent to reaffirm state confidence and propagate freedom to pursue self interests.<sup>76</sup> Furthermore, the US continues to positively influence the Asia-Pacific Economic Cooperation forum (APEC) by promoting free trade and open markets especially important given the global economic situation and staggering US national debt. Ultimately, for the US and China, the dependence on foreign energy sources raises concerns for overall global energy security due to existing vulnerabilities that include supply disruptions and price volatility.<sup>77</sup> Needless to say, like the US, China has underestimated the influence of the multinational arena.

Perhaps China should amend its strategy by investing in the economies of emerging states to bolster interdependence, cooperation, and foster mutual trust. Likewise, rather than speak of energy security as a state interest, the US must engage with China as a multinational partner and acknowledge China's energy security dilemma as a global interest common to all. The international community and certainly the claimants to the Spratly and Parcel Islands would rest better with some guarantee of



assured access to global energy resources without the threat of a state-controlled monopoly. US efforts must include the UN and ASEAN to advocate not only regional solutions to China's energy insecurity, but global solutions. Given worst case, the international community risks diminished freedom of navigation and unhindered access to the South China Sea if China begins patrolling its EEZ with the PLAN. Clearly, this doesn't appear to be an option at the moment since China relies on the SLOC for its livelihood and appears reluctant to elevate any issue to the ICJ that could prove unfavorable to China.

China's move to expand its EEZ is indicative of a coercive effort to gain competitive advantage by influencing trade as well as exploiting not only energy, but other natural resources including fish stocks. Permitting China's claims to go unopposed only serves to bolster its position especially if such claims conflict with international law. Engaging the UN and ASEAN could serve to strengthen a revised Code of Conduct that incorporates a free trade agreement and freedom of navigation rules into a broader set of guidelines to dissuade actions from escalating to conflict. Most importantly, the US must garner multinational support to preclude any perception of a US-led effort to contain China while backing the diplomatic efforts of Pacific partners and allies.

Certainly, based upon the reluctance of any claimant to budge on the issue of sovereignty, resolution of the territorial dispute appears beyond negotiation. Instead, the US can only leverage its power and influence in the energy sector to try to reassure China of unhindered access to energy. The US and others should also consider accelerating export of certain technologies to China to help improve energy supply

diversification as well as transportation infrastructure. Perhaps, this could be negotiated as part of a bilateral agreement toward mutual cooperation in emerging energy producing states in Africa and Central Asia. Furthermore, the US must reassess whether or not the influence it is trying to achieve on nations that have little options but to turn to China, is worth the costs.

US commitments to the Philippines, Korea, Japan, Taiwan, and renewed relations with Vietnam serve to strengthen US resolve in Asia, yet risk further perceptions of containing China. As a result, the US, China, and its neighbors must strengthen diplomatic efforts by communicating freely over energy and security issues. Given the sensitivity of the energy issue, perhaps China and its neighbors should be encouraged to pursue cooperative security efforts in the SLOCs through interoperability and exchange training exercises to build trust. As the world's foremost naval power, the US will have to take a lead role in shaping such efforts while also demonstrating its commitment toward preserving global interests. Finally, all parties need to expand trade and markets to bolster economic interdependence as a deterrent to conflict.

Last year, China and the US signed a joint statement on energy security pledging to uphold and strengthen the principles of mutually beneficial cooperation to stabilize international markets, diversify supply, and ensure the rational and efficient use of energy.<sup>78</sup> However, as demonstrated throughout this paper, the suspicion that lies between China's words and actions brings to question the validity of this pledge given the nature of China's interests. China's ideology, the influence of the CCP on its policies and practices, NOC exploitation, and genuine disinterest in committing to international law lead one to speculate on the outcome of the South China Sea dispute.

In all, China's playful display of sincerity toward a peaceful resolution of the dispute is contradicted by actions that indicate otherwise. Cumulatively, they add clarity to China's rejections over state conformity to any universal political or economic standard in concert with its communist ideology.<sup>79</sup> The question becomes whether or not China is ultimately exercising its *Tao guan yang-hui* strategy that stresses maintaining a low profile, hiding intentions, biding time, and measured moves to better position itself for a more favorable outcome later?<sup>80</sup>

### Conclusion

As demonstrated, China's energy insecurity and the South China Sea dispute present a significant problem for not only China, but the US and key partners that depend on the South China Sea as a trading corridor. Access to Asian markets remains a vital interest to not only the US, but the international community. The US must engage and continue to emphasize security, economic prosperity, and adherence to values in concert with its National Security Strategy while remaining cognizant of a rising China that desires to reach its full potential. All interested parties should note the role of international relationships, security alliances, and free-trade when conceiving future energy policies.<sup>81</sup>

Clearly, a multilateral approach to the South China Sea dispute seems unavoidable due to rising energy stakes, the extent of the dispute which includes mistrust between claimants, CCP influence, and the interests of international stakeholders. However, this will require substantial leadership and engagement to create a forum conducive to servicing the interests of the various parties. Clearly, a policy of engagement requires a considerable amount of trust that must extend not only

into, but beyond the instruments of power. When states do not trust each other, greater security for one undermines the security of the other.<sup>82</sup> In this case, mistrust has extended to other Southeast Asian nations that have opted to modernize their militaries including Japan, Australia, Vietnam, Singapore, and Malaysia. Ultimately, expanding militaries risk a regional arms race that could eventually lead to power struggles and the proliferation of technology that could be used to produce weapons of mass destruction (WMD).<sup>83</sup>

As China's energy demand increases, tensions over territories that possess the potential to offset China's energy needs will continue to escalate unless efforts are taken to balance the factors that contribute to overall energy security. Historically, China attempted to assert its energy "self-sufficiency" by depending on its domestic oil and coal reserves; however, this has proven insufficient. With globalization, the days of state-proclaimed "neo-isolationism" or "self-sufficiency" have largely been relegated to history due to the depletion of natural resources and the soaring demand for products otherwise unavailable. As states continue to modernize, the trade relationships they depend on to survive can ultimately lead to vulnerabilities that undermine security and raise the potential for conflict especially when it comes to energy resources. Although history has shown that trade interdependency has helped to mitigate the potential for conflict, it can lead to imbalanced relationships exacerbating state desires for hegemony.

China's well-publicized rise remains a heavily scrutinized issue among strategic analysts. Given China's territorial claims to not only the islands, but the vast majority of the South China Sea and its resources, it remains unclear whether such claims will

become a platform for cooperation or conflict. Although China's current trajectory may permit it to overtake the US economically within the next 15 to 20 years, whether or not China achieves diplomatic and military parity remain uncertain. Such uncertainties have exacerbated overall suspicions that accompany China's interests, its rise, and the threat it may impose on regional stability. At the moment, China's interests are clearly aimed at ensuring its survival. However, with China's unprecedented economic growth and modernization, it must now confront the challenge of competition that accompanies global trade as well as embrace its role as a major player in the international system to sustain its growth. Whether China's rise is peaceful or not will depend on its adaptability to global markets and responsiveness to international competition that drives such markets especially in light of its evolving energy security dilemma and ongoing territorial disputes in the heavily contested and now "energy rich" areas of the South China Sea.

### Endnotes

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<sup>3</sup> Main elements of the Go-out strategy include a more active, energy-centric form of commercial diplomacy within the key energy exporting regions, combined with a widening campaign by China's three major national oil companies to secure equity investments in oil and gas fields abroad (i.e., physical control over oil supplies). See Kenneth Lieberthal and Mikal Herberg, China's Search for Energy Security: Implications for U.S. Policy (National Bureau of Asian Research, Vol 17, No 1, April 2006), 13.

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<sup>6</sup> Samuel P. Huntington, *The Clash of Civilizations: Remaking of World Order* (New York, NY: Touchstone, 1997), 218.

<sup>7</sup> These concepts are best encapsulated by Thucydides' account of the speeches of the Corcyraeans and Corinthians in Athens. See Robert B. Strassler, ed., *The Landmark Thucydides: A Comprehensive Guide to the Peloponnesian War* (New York, NY: Free Press, 1996), 21-28; Also see Roy Stapleton, Ruan Zong-se, and Robert Kagan, *China's Peaceful Rise?* Panel III, Carnegie Endowment for International Peace Conference, September 21, 2004 (available at <http://www.carnegieendowment.org/pdf/day2-panel3.pdf>)

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<sup>9</sup> Zbigniew Brzezinski and John J. Mearsheimer, "Clash of the Titans," *Foreign Policy*, no. 146, January-February 2005, 46-50.

<sup>10</sup> Daniel H. Rosen and Trevor Houser, "China Energy: A Guide for the Perplexed," (Center for Strategic and International Studies, May 2007), 17.

<sup>11</sup> All data extracted from country-specific oil production and consumption data available at <http://www.iea.org> (accessed January 16, 2011) and <http://www.indexmundi.com> (accessed March 24, 2011).

<sup>12</sup> World Energy Outlook 2010 Executive Summary predicts China's energy demand will rise 75% by 2035 and account for nearly 22% of global demand...up from 17% in 2010. Data available at <http://www.worldenergyoutlook.org/2010.asp> (accessed March 8, 2011).

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<sup>14</sup> Lieberthal and Herberg, "China's Search for Energy Security: Implications for U.S. Policy," 11-12.

<sup>15</sup> Langdon D. Clough, ed., "Energy Profile of South China Sea," available at [http://www.eoearth.org/article/energy profile of South China Sea](http://www.eoearth.org/article/energy%20profile%20of%20South%20China%20Sea) (accessed December 30, 2010).

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<sup>17</sup> Kent Calder, *Asia's Deadly Triangle* (London: Nicholas Brealey Publishing, 1997), 203.

<sup>18</sup> Charles Horner, "New Power May Not Bring China Security," *Far Eastern Economic Review*, October 2009, 172, 8, 15-18.

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<sup>28</sup> *Ibid.*, 7.

<sup>29</sup> *Ibid.*, 16-18.

<sup>30</sup> Janes Sentinel Security Assessment: China and Northeast Asia, available at [http://www4.janes.com/subscribe/sentinel/CNAS\\_doc\\_view.jsp?Sent\\_Country=China&Prod\\_Name=CNAS&K2DocKey=/content1/janesdata/sent/cnasu/chins040.htm@current](http://www4.janes.com/subscribe/sentinel/CNAS_doc_view.jsp?Sent_Country=China&Prod_Name=CNAS&K2DocKey=/content1/janesdata/sent/cnasu/chins040.htm@current), (accessed November 2, 2010).

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<sup>51</sup> Map depicts competing territorial claims, overlapping Exclusive Economic Zones (EEZs), and existing oil exploration and production sites in the South China Sea. Maps available at <http://www.southchinasea.org/maps/US%20EIA,%20South%20China%20Sea%20Tables%20and%20Maps.htm> (accessed March 21, 2011).

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<sup>63</sup> Furtado, "International Law and the Dispute over the Spratly Islands: Whither UNCLOS?," 286-404.

<sup>64</sup> Valencia, Van Dyke, and Ludwig, *Sharing the Resources of the South China Sea*, 77.

<sup>65</sup> Such activity is prohibited by Article 19 of UNCLOS. See John J. Jackson, "China in the South China Sea: Genuine Multilateralism or a Wolf in Sheep's Clothing?" (Monterey, CA: Naval Post Graduate School), 65.

<sup>66</sup> Termsak Chalermpanupap, "Code of Conduct Over the South China Sea," September 4, 2010. Available at <http://www.nationmultimedia.com/home/2010/09/04/opinion/Code-of-conduct-over-the-South-China-Sea-30137260.html> (accessed January 11, 2011).

<sup>67</sup> Eikenberry, "Does China Threaten Asia-Pacific Regional Stability?," 95; Also see "In the Balance," *The Economist*, London, December 4, 2010, Vol. 397, Iss. 8711, 11.

<sup>68</sup> Leslie Hook, "China to Step Up Exploring in Deepwater," available at <http://www.ft.com> (accessed March 20, 2011).

<sup>69</sup> Peter Yuan Cai, "China's New National Energy Commission," available at <http://www.eastasiaforum.org/2010/03/12/chinas-new-national-energy-commission/>, (accessed March 20, 2011). See also <http://en.ndrc.gov.cn/mfndrc/default.htm> (accessed March 20, 2011).

<sup>70</sup> Daniel H. Rosen and Trevor Houser, "China Energy: A Guide for the Perplexed," (Center for Strategic and International Studies, May 2007), 43.

<sup>71</sup> Lieberthal and Herberg, "China's Search for Energy Security: Implications for U.S. Policy," 33.

<sup>72</sup> Shandre Thangavelu, "Will ASEAN Benefit from the ASEAN-China Free Trade Agreement?" available at <http://www.eastasiaforum.org/2010/01/27/will-asean-benefit-from-the-asean-china-fta/> (accessed March 21, 2020).

<sup>73</sup> Jing-dong Yuan, *China-ASEAN Relations: Perspectives, Prospects, and Implications for U.S. Interests* (Carlisle Barracks, PA: Strategic Studies Institute, U.S. Army War College, 2006), 9-11.

<sup>74</sup> United Nations, "Declarations or Statements Upon UNCLOS Ratification," Available at [http://www.un.org/Depts/los/convention\\_agreements/convention\\_declarations.htm](http://www.un.org/Depts/los/convention_agreements/convention_declarations.htm). (accessed February 21, 2011).

<sup>75</sup> John J. Jackson, "China in the South China Sea: Genuine Multilateralism or a Wolf in Sheep's Clothing?," (Monterey, CA: Naval Post Graduate School), 10.

<sup>76</sup> "Obama, ASEAN to Call for Peaceful End to Sea Spats," available at <http://biz.thestar.com.my/news/story.asp?file=/2010/9/20/business/20100920075335&sec=businbus> (accessed March 15, 2011).

<sup>77</sup> Ryan Clarke, *Chinese Energy Security: The Myth of the PLAN's Frontline Status* (Carlisle Barracks, PA: Strategic Studies Institute, U.S. Army War College, 2010), 4.

<sup>78</sup> Department of State, "US-China Joint Statement on Energy Security," US Federal news service, May 26, 2010. Available at <http://www.state.gov/r/pa/prs/ps/2010/05/142179.htm> (accessed January 15, 2011).

<sup>79</sup> Richard Weitz, *China Russia Security Relations: Strategic Parallelism Without Partnership or Passion?* (Carlisle Barracks, PA: Strategic Studies Institute, U.S. Army War College, August 2008), 36-40.

<sup>80</sup> Tao guan yang-hui actually means "hide brightness, nourish obscurity" popularized by Deng Xiaoping's strategic maxim in the 1990s. See David Lai, "The Coming of Chinese Hawks," (Strategic Studies Institute, Carlisle Barracks, PA, U.S. Army War College, October 2010), 2.

<sup>81</sup> Aaron L. Friedberg, "Going Out: China's Pursuit of Natural Resources and Implications for the PRC's Grand Strategy," (Seattle, WA: The National Bureau of Asian Research), Vol. 17, No. 3, September 2006, 30-34.

<sup>82</sup> "In the Balance," *The Economist*, December 4, 2010, Vol. 397, Issue 8711, 11.

<sup>83</sup> Calder, *Asia's Deadly Triangle*, 5.

